



OFFICE OF THE
CITY AUDITOR

**AN AUDIT OF THE CITY'S
PAYROLL DISBURSEMENTS
FOR THE SIX MONTHS ENDING JUNE 29, 1985**

A REPORT TO THE
SAN JOSE
CITY COUNCIL
MARCH 1986

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EXECUTIVE SUMMARY

In accordance with the San Jose City Charter Section 805(a), we examined the City's payroll disbursements for the six-month period covering December 16, 1984 through June 29, 1985. Beginning July, 1, 1985, the City Auditor put the audit of payroll disbursements on a periodic rather than a continuous audit cycle.

From the 207 payroll payments tested we noted forty exceptions, including eight that affected gross pay. The gross pay error occurrence rate of 3.9% found in the sample exceeds the gross pay error rate found in the previous year's samples. The majority of these errors (6 of 8) were due to an incorrect night shift premium rate, that resulted in relatively minor overpayments for each affected employee. The dollar effect of the gross pay errors (\$89.20) was .037% of the total gross pay tested. In addition, the noncompliance error rate of 2.2% found in this period's sample exceeds that found in the previous year's samples. (See ATTACHMENT I for comparative data.)

RECOMMENDATIONS

In order to enhance communication and reduce the possibility of error, it is recommended that:

Recommendation #1:

The Finance, Information Systems, and Personnel Departments collectively determine the format and level of detail necessary to properly communicate labor compensation changes requiring payroll system changes. (Priority 3)

Recommendation #2:

Payroll Section employees should exercise due care and diligence to insure that manual payroll adjustments are made in accordance with Payroll Section written instructions. In addition, the Payroll Section Supervisor should review, on a selective basis, manual payroll changes and document the results of those reviews. (Priority 3)

Recommendation #3:

The Finance Department should reorientate Department timekeepers with timesheet explanation requirements for overtime worked and sick leave taken. (Priority 3)

AUDIT OF THE CITY OF SAN JOSE'S
PAYROLL DISBURSEMENTS FOR THE
SIX MONTHS ENDED JUNE 1985

AUDIT SCOPE

In accordance with the San Jose City Charter Section 805a, we examined the City's payroll disbursements for the six month period covering December 16, 1984 through June 29, 1985.

Past audits of the City's payroll disbursements covered a one-year period, however, this review was for six months. Beginning July 1, 1985, the City Auditor put the audit of payroll disbursements on a periodic rather than a continuous audit cycle.

From the 207 payroll payments tested during this period, we found the following exceptions:

| <u>Number of Exceptions</u> | <u>Description of Exception</u> | <u>Dollar Impact</u> |
|---------------------------------|--|----------------------|
| 6 | Overpayments of Night Shift Premium | \$17.20 Overpaid* |
| 1 | Coding Error in making deductions for West Coast Life Insurance Premiums | n/a |
| 2 | Incorrect Raise Due Codes | \$72.00 Overpaid |

*Test expanded to include an additional 107 employees with a resultant dollar impact of \$1,615.10 overpaid.

| <u>Number of Exceptions</u> | <u>Description of Exception</u> | <u>Dollar Impact</u> |
|---------------------------------|--|---------------------------------------|
| 1 | Incorrect Workweek Code | Overcredit of 32 Vacation Hours |
| 1 | Overtime worked not explained on Timesheet | n/a |
| 8 | Sick Leave Entries not explained on timesheets | n/a |
| 9 | Lack of supporting documentation showing authorization for tax withholding | n/a |
| 12 | Lack of supporting documentation showing authorization for voluntary deduction | n/a |

It should be noted that the gross pay error occurrence rate of 3.9% found in the sample exceeds the gross pay error rate found in the previous year's samples. The majority of these errors (6 of 8) were due to an incorrect night shift premium rate, that resulted in relatively minor overpayments for each affected employee. The dollar effect of the gross pay errors (\$89.20) was .037% of the total gross pay tested. In addition, the noncompliance error rate of 2.2% found in this period's sample exceeds that found in the previous year's samples. (See ATTACHMENT I for comparative data.)

Overpayments of Night Shift Premium

In our sample, we found 6 instances of overpayment of night shift premium because the night shift premium rate was erroneously entered into the payroll program. This resulted in an average overpayment of \$2.87 per pay period per affected employee. We expanded our sample to include all employees subject to this error and found the City had overpaid 113 employees a total of \$1,615.10 for the period April 21 through July 13, 1985.

The above error occurred when the Personnel Department - Labor Relations Office compiled an informational document listing various bonuses and premium pay rates for different employee groups. Unfortunately, the night shift differential listed for Operating Engineers was overstated by 5 cents per hour. As a courtesy, Labor Relations provided the Payroll Section with a copy of the informational document. After reviewing the document, the Payroll Section directed the Information Systems Department to adjust the night shift differential for Operating Engineers to coincide with the incorrect rate shown on the informational document. According to Labor Relations personnel, the document was not intended to initiate changes to the payroll system but was merely for informational purposes.

The Payroll Section decided not to require the employees to pay back the \$1,615.10 because of the small individual amounts involved (approximately \$14.00 per employee). The error was corrected when a second raise in the night shift differential became effective on July 14, 1985.

Coding Error for West Coast Life Insurance Premium Deductions

We found an instance of an Information Systems Department coding error. This error resulted in deductions for West Coast Life Insurance dependent coverage premiums not being made for the employees in the Engineers and Architects Unit for ten months.

Effective July 14, 1984, the Engineers and Architects Unit's benefits were changed to those similarly given to the midmanagement group. The Information Systems Department should have recoded the Payroll Program to deduct 23 cents per employee pay period for the Engineers and Architects Unit employees but did not. According to Information Systems personnel, the absence of a standardized format to communicate payroll changes contributed to the coding error.

In our opinion, the above overpayment of night shift premium and the coding error indicate a weakness in control procedures over payroll change entries. The Personnel Department is currently developing formal procedures for the

timely and accurate communication of labor compensation changes. The process of implementing these changes would be enhanced if the Personnel, Finance and Information Systems Departments would collectively determine the format and level of detail necessary to properly communicate those instances requiring payroll system changes.

Incorrect Raise Due Codes

We found two instances where the Payroll Section did not correctly set an employee's Raise Due Code. A Raise Due Code is the pay period an employee is eligible for an annual pay increase. One instance resulted in a \$72.00 overpayment to an employee, which the Payroll Section subsequently recovered. After we notified the Payroll Section, the second instance was corrected before any payment errors occurred.

Incorrect Work Week Code

We found one instance where an employee was overcredited 32 hours of Vacation Time Available due to an incorrect work week code. This employee moved from a management level class to a non-management class, but continued to receive vacation credit at the management rate.

According to the Payroll Section Supervisor, Payroll Section employees make approximately 1700 manual payroll

adjustments per pay period. Manually set Raise Due Codes and Work Week Codes are part of these adjustments.

In our opinion, Payroll Section employees should exercise due care and diligence to insure that manual payroll adjustments are made in accordance with Payroll Section written instructions. In addition, the Payroll Section Supervisor should review on a selective basis manual payroll changes and document the results of those reviews. Such a procedure will

- 1) enhance internal control over manual payroll changes and
- 2) provide the Payroll Section Supervisor with an additional means of evaluating Payroll Section employees.

Inadequate Explanations on Timesheets

We found nine noncompliance exceptions where employees did not comply with established procedures for the completion of time sheets.

The Finance Department Procedures Manual, Payroll Section, Employee Instructions for Completing Bi-Weekly Time Report section 2.3 requires an entry in the "Explanatory Remarks" section of the time report for overtime worked. The explanation should show the date, inclusive time of day worked,

reason for overtime and work location. In addition, the Personnel Administrative Manual Section 13.05.5 requires an explanation in the "Remarks" section of the time card for sick leave usage. The explanation should show the date(s) and reason the employee was absent.

The exceptions noted involved the failure to provide explanations of overtime worked or sick leave taken as described above. Department timekeepers are responsible for assuring that time sheets are complete and accurate. In our opinion, the Finance Department should reorientate Department timekeepers with the above explanation requirements.

Lack of Authorization for Payroll Deductions

We found twenty-one noncompliance exceptions, where the employee's file 1) did not contain documents authorizing the deductions being made from the employee's pay or 2) the employee's file contained documents authorizing deductions from the employee's pay but those deductions were not being made.

The deductions in question are summarized below.

*SUMMARY OF DISCREPANCIES BETWEEN
DEDUCTIONS DOCUMENTED IN EMPLOYEE
FILES AND PAYROLL DEDUCTIONS*

| <u>Employee</u> | <u>Tax With- holding</u> | | <u>Insurances</u> | | | <u>Sal- ary</u> | <u>Charitable</u> |
|-----------------|------------------------------|--------------|-----------------------|-------------|-----------------------|---------------------|-------------------|
| | <u>Fed</u> | <u>State</u> | <u>Blue Cross</u> | <u>Life</u> | <u>Acci- dent</u> | | |
| #1 | | X | | | | | |
| #2 | | | | | | | X |
| #3 | X | X | | | | | |
| #4 | X | X | | | | | |
| #5 | X | | | | | | |
| #6 | | | | | | | X |
| #7 | | X | | | | | |
| #8 | | X | | | | | |
| #9 | | X | | | | | |
| #10 | | | | X | X | | |
| #11 | | | X | | | | |
| #12 | | | | | X | | |
| #13 | X | X | | | | | |
| #14 | | | | X | | | |
| #15 | | | | | | X | |
| #16 | | | | X | | X | |
| #17 | | | | X | | | |
| #18 | | | | X | | | |
| #19 | | | | | X | | |
| #20 | | X | | | | | |
| #21 | | | | X | | | |

At this time it is not possible to assess the exact cause for the above discrepancies. However, the City Auditor will expand the scope of the next periodic payroll audit to address this issue.

RECOMMENDATIONS

In order to enhance communication and reduce the possibility of error it is recommended that:

Recommendation #1:

The Finance, Information Systems and Personnel Departments collectively determine the format and level of detail necessary to properly communicate labor compensation changes requiring payroll system changes. (Priority 3)

Recommendation #2:

Payroll Section employees should exercise due care and diligence to insure that manual payroll adjustments are made in accordance with Payroll Section written instructions. In addition, the Payroll Section Supervisor should review, on a selective basis, manual payroll changes and document the results of those reviews. (Priority 3)

Recommendation #3:

The Finance Department should reorientate Department timekeepers with timesheet explanation requirements for overtime worked and sick leave taken. (Priority 3)

CONTINUOUS PAYROLL REVIEW
For the Period 12/16/84 through 6/29/85

STATISTICAL SUMMARY

| <u>Universe and Sample Size</u> | <u>1/2 Yr. 1985</u> | <u>1984</u> | <u>1983</u> |
|--|-------------------------|----------------|----------------|
| Total number of checks and automatic deposit issued: | | | |
| Checks | 47,776 | 86,098 | 101,170 |
| Automatic deposits | 21,342 | 35,774 | 30,550 |
| Total | <u>69,118</u> | <u>121,867</u> | <u>131,720</u> |
| Total number of checks and automatic deposits tested: | | | |
| Checks | 126 | 259 | 328 |
| Automatic deposits | 81 | 121 | 120 |
| Total | <u>207</u> | <u>380</u> | <u>448</u> |
| <u>Total gross pay for the Period (in thousands)</u> | \$78,728 | \$136,844 | \$126,512 |
| <u>Total gross pay tested</u> | \$240,785 | \$429,088 | \$484,533 |
| <u>Exceptions Noted</u> | | | |
| Gross pay errors noted | 8 | 0 | 3 |
| Percentage of gross pay errors to payments tested (Error rate) | 3.9 | 0 | 0.7% |
| Maximum gross pay error rates (from statistical tables) | n/a* | 1.5% | 3.6% |
| Overpayments | \$89.20 | 0 | \$304.32 |
| Underpayments | 0 | 0 | \$ 21.60 |

*A statistical projection of the "Maximum gross pay error rate" is not available for the current period. Since this review was limited to six months, the size of the sample tested was not sufficient to project a statistical conclusion of the test results to all the payroll payments during the period.

| | <u>1/2 Yr. 1985</u> | <u>1984</u> | <u>1983</u> |
|--|-------------------------|-------------|-------------|
| Procedural compliance exceptions noted | 32 | 45 | 48 |
| Total attributes tested | 1465 | 2689 | 4480 |
| Percentage of procedural compliance exceptions to total attributes tested (Error rate) | 2.2% | 1.7% | 1.1% |

CITY OF SAN JOSE - MEMORANDUM

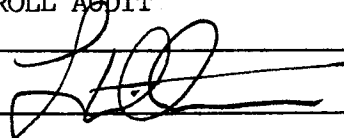
TO: Honorable Mayor and City Council

FROM: Edward G. Schilling
Director of Finance

SUBJECT: RESPONSES TO PAYROLL AUDIT

DATE: March 12, 1986

APPROVED



DATE

Finance is pleased to receive such a favorable review on their payroll disbursement function. The .037% gross pay error rate while up from 0% in 1984 confirms the efficiency of the payroll operations, as well as their excellent documentation of payroll procedures. Our responses reflect what is accepted as a standard in the audit profession, namely, that "the objective of internal control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived, and also recognizes the evaluation of these factors necessarily requires estimates and judgements by management."

RECOMMENDATION NO. 1

The Finance, Information Systems (ISD) and Personnel Departments collectively determine the format and level of detail necessary to properly communicate labor compensation changes requiring payroll system changes.

Response

In the first instance cited in the report, that of an overpayment of night shift premium due to an erroneous addition of \$.05 to the hourly rate, Payroll had discovered the error long before the Auditor documented the discrepancy. A decision was made at the time of that discovery not to require repayment from employees, due to the small amounts involved in comparison to the significance of potentially antagonizing the bargaining unit during a time of labor negotiations.

The second instance, that of a programming error in insurance premium deductions, resulted from an unusual situation in which Personnel had, through labor negotiations, "split" a bargaining unit as to applicability of benefits. Minimal lead time was allowed to implement the change, and to test it before it went into effect. Normally, the policy is to test all programming changes sufficiently before they are implemented.

Currently, Payroll and ISD utilize a written "Request for Services," submitted by Payroll to ISD and signed off by Payroll after changes are made. The only exception to this procedure is emergencies where timing is critical. However, Accounting agrees with the Auditor that conceptual changes to the payroll system should be more clearly highlighted to ISD and that dual sign-off as to change verification should be required.

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Formal procedures have already been instituted among Employee Relations, Finance and Information Systems. The Auditor felt it would be more feasible to examine these in depth at a later date rather than to hold up issuance of this audit. However, Accounting agrees with the Auditor as to the importance of documentation, and will assist in whatever way possible to assure its successful implementation.

RECOMMENDATION NO. 2

Payroll Section employees should exercise due care and diligence to insure that manual payroll adjustments are made in accordance with Payroll Section written instructions. In addition, the Payroll Section Supervisor should review, on a selective basis, manual payroll changes and document the results of those reviews.

Response

As the Auditor points out, there are up-to-date written procedures covering all aspects of the payroll functions. The instances cited by the Auditor (incorrect raise due codes and an incorrect workweek code for one employee) involved human error, which realistically will never be completely removed from the operational environment. As a part of the balancing procedure for each pay period, a reconciliation is performed between net and gross pay, and between total other earnings and the individual earnings registers. Both these reconciliations are documented, and are designed to bring out any anomalies in dollar amounts paid. Since July, 1985, a manual review of all anniversary dates and scheduled pay increases has been performed, which would have caught the incorrect raise due code. The workweek code, since it affects only the individual's accrual rate for vacation, would not be highlighted by either of these procedures, however, any selective review of manual changes, already being performed, also failed to catch the error.

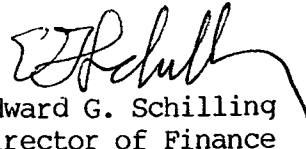
RECOMMENDATION NO. 3

The Finance Department should re-orient Department timekeepers with timesheet explanation requirements for overtime worked and sick leave taken.

Response

Payroll, along with staff from Financial Analysis and Personnel spent over a week and a half with the timekeepers in August going over the timekeeping requirements involved with implementation of new time-sheets. Another week of training is scheduled for the end of March, to orient timekeepers to the recordkeeping required by the activation of the Fair Labor Standards Act. Payroll takes its training responsibilities seriously, and endeavors to keep all City personnel aware of changes in procedures.

Respectfully submitted,



Edward G. Schilling
Director of Finance

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